

CAROUSEL FRAUD – METHOD FOR TAX DODGING IN THE AREA OF THE VAT ON INTRA-COMMUNITY LEVEL

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1. General considerations related to intra-community tax dodging VAT

The fraud and the dodging, in general meaning regarding the VAT distorts the well function of the unique market and is in detriment of the financial purposes of the member states, as well as the financing the community budget, impacting the loyal competition on the unique market, and decreases the fiscal incomes of the member states. This kind of fraud need approached in an efficient and firm way, in the interest of the enterprises that work in compliance to the fiscal legislation in force and to the state membership regulation.

The current VAT organization for the intra community commerce is based on the principles of applying the tax in the destination country in order to ensure an equal treatment among national products and foreign products coming from other European Countries, and constitutes in a mechanism that allows commodities circulation among the countries without exposing to taxes, being afterwards imposed in the destination country with the same quota as the internal transactions.

The tax dodging and fraud in the area of VAT have, equally, impact over financing the budget of the European Union, as their result constitutes in necessity to appeal more and more to the internal resources based on national gross income (NGI) of the member states. Taking into consideration that the calculation criteria of the resources based on VAT are different from the ones for NGI, these losses may impact with negative consequences on both financial

obligations of the member states, contrary to the equity principle.

Although not in all member states were carried on investigations regarding the proportions of the tax dodging and fraud in area of VAT, several estimations were published. *International* VAT estimates VAT losses in 60 – 100 mild euros per year on level of the European Union. Only in the United Kingdom, *HM Revenue and Customs (HMRC)* estimates that for the fiscal year 2005/2006, the losses registered in the incomes coming from the VAT were more than 18.2 mild euros. In Germany, the Ministry of Finance published results of a study according to which the losses of VAT registered for 2005 were up to 17 mild euros.

The VAT dodging is mostly related to the economic activities that are not declared (“shadow economy”). Still, major part from the VAT dodging appears as secondary effect of the unique market setting up in 1993. For the intra the community commerce, the commodities delivered are exonerated from the VAT, and the due VAT must then be paid in the member state where the commodity enters. This system may lead to a VAT dodging either in the supply country or in the destination country.

I consider that the main methods to accomplish tax dodging in area of VAT intra community may be the following:

- Declaring intra community deliveries while the commodities are stored for selling on the internal market, without VAT;
- Not paying due VAT when arrival in the destination country;
- Fraud with “missing trader” (carousel type).

The fraud mechanisms are often sophisticated, as they assume several member states and involve participation from a large number of companies. For example, Eurojust drew attention, in March 2007, to a case of carousel type fraud in area of VAT on international level; the fraud was estimated to 2.1 mild euros and involved 18 member states. According European Committee the fiscal evasion reaches the level of 2 – 2.5 of the GIP (Gross Internal Product), meaning a value around 200 – 250 mild euro. In September 2006, the Authorities in Great Britain and Holland ended “carousel” type VAT dodging set up, that caused during recent years damages estimated to 5 mild USD. Following up the investigation, First Curacao International Bank in Carraibe was shut down as majority of the persons suspected with fraud had bank accounts open here.

It is estimated that in *Romania* this level of fraud decreased, but still reaches over 10% from the collections of VAT. A potential increase of the taxes and indirect fees could not stop the fraud. On the other hand, the Romanian legislation in force related to VAT is harmonized with the 6th European Directive, so that any major modification would impact in derogations, which is very difficult to accept. While the level of indirect taxation was recently increased on global level in the member states, in Romania the last major measurement was decreasing the VAT quota from 22% to 19%, as of 2005. VAT has the greatest share in the state budget, exceeding the level in other UE member states. I consider that explanation for this seeming paradox is simple: on one hand, Romania is an increasing consumption market; on the other hand, the VAT collection level is much increased in comparison to the other taxes and fees.

The common information exchange among the member states is regulated throughout the Regulation (CE) no 1798/2003 regarding the administrative cooperation in area of VAT.

2. Carousel type fraud – content and effects

I consider that the type of VAT dodging with worst consequences measured throughout the value of the amounts eluded from payment and it is very difficult to be detected is the one known as „**carousel fraud**”.

This type of fraud, even if not recent discovered, was extended simultaneously with setting up the VAT intra community. Indeed, the lack of control on national borders facilitates implementation of invoicing circuits without circulation of the commodities. Circulation, tax excluded, of the commodities inside the Community benefits implementations of fraud networks, very not transparent due to their european extension. Although the transit setting up for the intra community commerce facilitates circulation of commodities, on one hand, and exposes the member states to individual losses result from the evasion and tax dodging.

Carousel type fraud became possible mostly due to inadequate cooperation among the member states, but also due to different imposing quotas. Following up, we consider in place request to setting up function of all types of cooperation and information exchange in order to combat with this phenomenon in an efficient way.

Related to decreasing carousel type fraud, some national legislation in force regulate norms to set up solitary responsibility for the buyer for the VAT payment, that the supplier did not pay for several categories of products for which the selling price is lower than the normal value. The regulations come from article 21 in the 6th Directive, allowing member states to make a person solitary responsible for paying the VAT, other than the person responsible in a direct way, in conformity with proportionality principle. The reasons for this are based on the assumption that transactions with prices different from the market price may be, in fact, a mask for a situation

completely different in its core, a situation involving a tax dodging case.

The Economic and Social European Committee agrees on the concern related to the principle of solitary responsibility, and, taking into consideration the jurisprudence of the justice Court, considers that any regulation should be limited to searching and requesting payment guarantees for payment from the parties clearly identified as being the parties obliged to pay the taxes. Having these drastic disposals, becomes clear the fact that, when the buyer is punished to pay a tax that other parties avoid throughout the tax dodging, it is necessary that the practical appliance of the regulations is limited to several specific terms:

- Transaction must be agreed between paying VAT parties, explicitly excluding final consumers;
- Supplier did not accomplish full or partial payment of the due VAT;
- Supplied commodities must belong to one of the categories explicitly described by legislation in force;
- Commodities must be supplied with lower price than the nominal price;
- Difference between agreed payment and normal value may not be justified by events that may be proved in objective way.

3. Function mechanism

Carousel type VAT dodging is organized in several entities, in order to obtain reimbursements of a tax that was never paid upstream or decreasing VAT debt.

The mechanism of the carousel type fraud is simple: this type of intra community fraud assumes existence of some fictitious and/ or short lived companies, having main function set to establish correct invoicing (VAT included), with purpose to allow the company located downstream to retrieve this VAT, without paying in the VAT. The commodities are first imported in an EU country where the trading is excluded

from VAT imposing. When they are sold, a fictitious VAT is added to the price, and the supplementary amount of money is collected by the traders, instead of being paid to the state authorities as a tax. The "carousel" is formed when the product is re – exported to another country with no VAT imposing. In the moment the commodity passes the border, a reimbursement of VAT is requested by the exporting company, although it was never paid. The amounts that are dodged increase proportionally to the number of times this set-up is repeated. Sometimes, the set-up is "recycled" even outside the EU: after being dragged in some European countries, the product is exported in a country outside EU, where VAT is not imposed, and then it is reintroduced in the European circuit.

I consider that the main "actors" involved in tax dodging throughout the carousel type fraud may be the following:

- Missing trader – is the protagonist of the fraud, and, generally, is the company with no real activity, administrated by interface persons. The missing trader may purchase commodities without paying in VAT to its suppliers in EU, and to sell the same commodities with VAT included, without ever paying in the collected VAT;

- The buffer company – may have real activity or not – its goal is to purchase and sell large quantities of commodities, without adding value. Their purpose consists in making the operations and invoicing more appropriate to reality, and to complicate the process of detecting the fraud;

- Conduit Company is another international buffer, with same activities as the buffer company – difference consists in the fact that it is established in another state than the client is, and stimulates the fraud in their client's state. These companies do not accomplish dodging in the countries where they are established.

Bellow I will try to highlight the set up of a carousel type fraud starting in Romania:

Supplier A carries on a delivery to client F, both located on Romania territory. Supplier A carries on a delivery to client B located in Belgium, with VAT residence, and the intra community delivery, VAT exonerated, is invoiced to 100 units VAT excluded. B Company, who does not declare the purchasing, invoices the commodities to C Company also located in Belgium, to 105 units VAT included, meaning 87 units VAT excluded, and this way accomplishing 5 units win. C Company, declares the purchasing, collects the VAT that was invoiced to it, and invoices the commodity to D Company registered with VAT residence in Czech Republic, to 95 units VAT excluded, as intra community delivery VAT exonerated, accomplishing an 8 units win. The same set-up is reproduced with D Company that does not declare, and the E Company that declares. The F client purchases the commodities with a lower price compared to the initial price, which allows him to resell it in a very competitive price, while for these type of commodities the selling price is established by official distributors. It may be possible that Company A will repurchase, in the end of the circuit, the commodities that initially traded.

In the above mentioned set-up, the VAT dodging is established in Romania (the commodities do not pass Romanian borders, the intra community delivery is pure fictitious), and the other 2 member states (not pay in the VAT invoiced and fake intra community delivery, if case). The A supplier is not necessarily accomplice, the selling is made in delivery conditions, he just ignores the real destination of the commodities, but B, C, D, E are accomplices. Still, if the commodity is properly delivered by C and E, it may be possible that they are not accomplices. In each member state, there may be several companies not declaring – this consists in greater lack of transparency. The increase of the number of the member states involves increase of the efficiency of the tax dodging inside the same carousel.

Regarding the **means of control and investigation of this kind of fraud**, I consider that the most important objective is identification of the “missing trader” companies and the control of the concrete flow of the commodities.

In case of VAT reimbursements from companies with turnover fast increased in short time, the same operational method should be preferred. Existence of double game of invoicing is not yet excluded. This allows an amount with Vat excluded to transform itself in an amount with VAT included, maintaining same payment and disassembling the real supplier. In this case, the social location of the 2 suppliers are neighbors, in order to facilitate the collections).

4. Means of decreasing tax dodging on European level

VAT represents the tax with the fastest increase on global level; from development of indirect taxation perspective, an additional challenge that may not be ignored appears. The VAT systems may be regressive or even inflationist.

Towards the implemented VAT systems as the European Union one, the VAT systems introduced in recent 10 years (e.g. Australia and Singapore) seem to facilitate much less the tax dodging ensuring in the same time of higher level of following the regulations for reporting requests. I consider it is mandatory a complex debate towards the issues related to fraud based on the lacks in the intra community commerce (or carousel type fraud) that corresponds the necessity to answer a business environment very competitive on global level.

The analysis and comparison of the systems on international level demonstrates the fact that no system is perfect. There is clear tension between the needs to eliminate the possibility of not following the regulatory reporting requests and the frauds on one side, and the needs to activate so that the

administrative load of the tax payers will not restrain their competition potential.

The tax and indirect fee systems evolve. The constructive dialogue between Authorities and tax payers will be essential to the development of tax and indirect fees systems that would work efficiently. The capacity of the governmental and financial authorities and of the tax payers to cooperate towards the same goal is fundamental for a firm agreement and general acceptance of standards that would function on international level.

A good example towards the means of struggling against tax dodging on intra community level are programs "Fiscalis 2007" and VIES.

Fiscalis 2007 is a multiannual activity program of the Committee meant to improve and coordinate the indirect taxation of the EU states, and to consolidate cooperation between member states. First step of the program (1998 – 2002), established through the Decision 888/1998/CE agreed by European parliament and Committee, was supporting the fiscal policies measures meant to improve the strategies for controlling and struggling against the dodging in indirect taxation. Second step (2003 – 2007) was adopted in conformity with disposals of the Decision no 2235/2002/CE, which extended the area of measures in the income taxation.

The goal of *Fiscalis 2007* is adopting a structured approach regarding the communication and information exchange systems among distinctive fiscal administrations, allowing European system to function as one single administration, in order to protect the financial interests of the Community by struggling against the tax dodging by eliminating distortions of the competition.

VIES (VAT Information Exchange System) is an information exchange system related to VAT, and constitutes of an electronic network for transmitting information related to validity of the VAT identification numbers of the companies registered in the member states. The

information related to the registration data in VAT purposes are collected by national administrations, then introduced in the national databases in order to allow distant consultancy. This system was instituted in order to compensate elimination of the formalities and the custom controls.

5. Regulation proposals

The intra community commerce with goods and services is currently regulated with VAT exoneration, as this tax is supposed to be imposed only in the final consumer's country. For future is forecasted that the VAT would be paid in in the beginning of the distribution chain rather than the final distribution of the product country. Within this system, the national fiscal authority that collects VAT would be responsible for the reimbursements of the VAT collected funds towards the destination country. This solution seems to be the most innovator and promising proposal, but I appreciate it would be very difficult to accomplish it, as implementation requires a unanimous agreement.

I consider that solutions most likely to decrease the sizing of the tax dodging in area of VAT intra community may be the following:

- A much stronger strengthen of the national fiscal controls;
- Introduction of the "inverse taxation" system, supported by United Kingdom of Great Britain, Germany, Austria, among European companies that apply their own VAT for the services provided by other members states or third states, as it is currently in the field of constructions;
- Improve cooperation among member states by introducing new administrative mechanisms, legislative initiatives, creation of a Community Forum for administrative cooperation;
- Development of a community approach of the relations with third parties;

- Modifications in the current excise and VAT systems in order to strengthen the principle of solitary responsibility for tax payment;

- Harmonization, on European Union level, of the sanctions towards the fraud cases the comparable gravity level, as already forecasted, for example, in the cases of “money washing”. This could interrupt appearance of situations when a less strict legislation or less efficient audit systems would allow creation of true “fiscal paradises”, for the incomes obtained through infrational activities and for realization of the carousel type fraud.

The measures for struggling against fiscal evasion must be in conformity with the EU principles, including the ones regarding the non discrimination and proportionality. One of the areas where there is a great difference from one system to another includes the criteria used for determination of the amount to be imposed which differs from the payment agreed by the parties, not only in the cases of commodities for private consumption or other purposes than the commercial ones, but also in cases where great level of risk for fraud or tax dodging exists.

In this respect, the systems of all member states the criteria for determining the imposing base is greatly based on the will to negotiate of the parties and follows guarantees for imposing the effective payment, due to the fact that the imposable base is usually the amount agreed through contract for the goods or services contracted.

The VAT dodging determined fiscal authorities of the member states to perfect more and more the investigation techniques, meaning to struggle more efficient against the phenomenon. Through adequate instruments, constituted based on treaties, the member states instituted an information exchange system that proved itself efficient in determination of the status of the tax payer, and for struggling and decreasing against international fiscal fraud.

For accomplishing this goal, the obstacles to an administrative culture of European Union must be exceeded, stimulating full usage of the cooperation instruments currently in place, and fulfilling the deadlines and procedures in force, so that the investigation institutes would have all requested information for their reports in due time.

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